Solution 22.1

a) Debenture discount is written off against profit before tax, but has no cash flow implications. Hence, the cash actually received on the issue of the debentures is reflected under financing activities in the year of issue and the amount of debenture discount written off is adjusted for under non-cash items in the notes to the Statement of cash flows every year.

b) As for debenture discount written off, the impairment of goodwill must be added back to profit before tax as an adjustment for non-cash flow items.

c) Deferred tax is a book entry with no cash flow implications. The tax paid amount per the Statement of cash flows should therefore only consist of the payments made for the year.

d) An under-provision of tax in the previous year will have to be made good in the current year. It is therefore normally included in the payments for the year and must be considered when calculating these payments.

e) The actual cash flow for the year is C2 000. This is therefore the amount that must be included on the Statement of cash flows.

Solution 22.2

a)

HICKORY LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 JULY 20X6

		C
Cash flows from operating activities		
Cash receipts from customers	W3	2 950 000
Cash paid to suppliers and employees	W4	(2 274 500)
Cash generated from operations		675 500
Taxation paid	W5	(259 500)
Net cash inflow from operating activities		416 000

b)

Profit before tax (from SOCI)	W1	650 000
Adjusted for non-cash and non-operating items		30 000
Depreciation	W2	35 000
Profit on sale of plant		(5 000)
Working capital changes		(4 500)
Decrease in inventories		8 500
Increase in accounts receivable		(43 000)
Increase in accrued expense		15 000
Increase in accounts payable		15 000
Cash generated from operations		675 500

or

Profit before tax (from SOCI)	W1	650 000
Adjusted for non-cash and non-operating items		37 000
Depreciation	W2	35 000
Doubtful debt allowance		7 000
Profit on sale of plant		(5 000)
Working capital changes		(11 500)
Decrease in inventories		8 500
Increase in accounts receivable		(50 000)
Increase in accrued expense		15 000
Increase in accounts payable		15 000
Cash generated from operations		675 500

Workings

W1 Profit before tax

C390 000/0.6 = C650 000

Solution 22.2 continued …

W2 Plant and equipment

PLANT AND EQUIPMENT			
Description	***C***	***Description***	***C***
Balance	450	***Disposal...1***	***40***
Cash	90		
		Balance	500
	540		540

ACCUMULATED DEPRECIATION: PLANT AND EQUIPMENT			
Description	***C***	***Description***	***C***
Disposal...2	***30***	Balance	45
		Depreciation	***35***
Balance	50		
	80		80

W3.Cash receipts from customers

ACCOUNTS RECEIVABLE			
Description	***C***	***Description***	***C***
Balance	400 000	**Bank**	**2 950 000**
Sales	3 000 000		
		Balance	450 000
	3 400 000		3 400 000

W4 Payments to suppliers and employees

Turnover less Profit before tax = COS plus expenses	2 350 000
Non-cash items	(37 000)
Depreciation	(35 000)
Profit on sale	5 000
Doubtful debts allowance	(7 000)
Working capital changes	(38 500)
Inventory	(8 500)
Trade payables and accruals	(30 000)
	2 274 500

or

ACCOUNTS PAYABLE			
Description	***C***	***Description***	***C***
Bank	***1 976.5***	Balance	235
		Inventory	1 991.5
Balance	250		
	2 226.5		2 226.5

INVENTORY			
Description	***C***	***Description***	***C***
Balance	348.5	Cost of sales	2 000
Accounts payable	***1 991.5***		
		Balance	340
	2 340		2 340

Solution 22.2 continued …

Revenue	3 000 000
Cost of sales	(2 000 000)
Gross profit	1 000 000
Expenses	***(350 000)***
Profit before tax	650 000

Net expenses	350 000
Non-cash items	
Depreciation	(35 000)
Profit on sale	5 000
Doubtful debt allowance	(7 000)
Increase in accured expenses	(15 000)
Cash paid for operating expenses	298 000

Therefore: 1 976.5 (cash paid to suppliers of goods for resale) + 298 (cash paid for operating expenses) = 2 274.5 (cash paid to suppliers and employees)

W5 Tax paid

CURRENT TAX PAYABLE			
Description	***C***	***Description***	***C***
Bank	***259 500***	Balance (o/b)	1 500
Balance (c/b)	2 000	Current tax	*260 000
	261 500		261 500
		Balance (c/b)	2 000

*Profit before tax: 650 000 x 40% = 260 000

Solution 22.3

a)

OLBAS LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

		C
Cash flows from operating activities		
Cash receipts from customers	(153 333 + 3 500 000 - 140 990)	3 512 343
Cash paid to suppliers and employees	W1	(2 826 183)
Cash generated from operations		686 160
Investment income received		3 200
Interest paid	[(136 268 – 96 268) + 100 000]	(140 000)
Taxation paid	[(6 440) + 177 888 – 12 888]	(158 560)
Dividends paid	(125 000 + 225 000 – 150 000) + 25 000	(225 000)
Net cash inflow from operating activities		***165 800***
Cash flows from investing activities		
Proceeds from sale of land and buildings		520 000
Proceeds from sale of investments	(125 000 + 12 450)	137 450
Purchase of equipment	(480 000 - 400 000)	(80 000)
Purchase of vehicles		(360 000)
Purchase of investments	(250 000 - 125 000 - 370 000)	(245 000)
Net cash outflow from investing activities		***(27 550)***
Cash flows from financing activities		
Issue of preference shares	(250 000 + 22 700)	272 700
Repayment of mortgage bond	(625 000 - 250 000)	(375 000)
Net cash inflow from financing activities		***(102 300)***
Net increase in cash		35 950
Cash at beginning of period		84 300
Cash at end of period		120 250

Solution 22.3 continued …

Note 1	
Non-cash financing and investing activities	
Profit on sale of land and buildings	70 000
Profit on sale of investments	12 450
Depreciation	108 000

b)

Profit before tax	(from SOCI)	576 982
Adjusted for non-cash and non-operating items		158 618
Dividend income	(from SOCI)	(3 200)
Finance cost	(from SOCI)	136 268
Depreciation expense		108 000
Profit on sale of land and buildings		(70 000)
Profit on sale of investments		(12 450)
Operating cash flow before working capital changes		735 600
Working capital changes		(49 440)
Inventory		(14 800)
Accounts receivable		11 850
Prepaid expenses		(340)
Account payable		(46 150)
Cash generated from operations		686 160

Workings

W1 Payments to suppliers and employees		
Revenue less profit before tax = COS + net expenses	(3 500 000 -576 982)	2 923 018
Non- operating items		(133 068)
Finance costs		(136 268)
Dividend income		3 200
Non-cash items :		
Depreciation	(168 000 - 120 000 + 60 000)	(108 000)
Profit on sale of land & buildings		70 000
Profit on sale investments		12 450
Decrease in doubtful debts allowance	(6 133 - 5 640)	493
Working capital changes		
Inventory (increase)	(146 000 - 131 200)	14 800
Prepaid expenses (increase)	(6 300 - 5 960)	340
Accounts payable (decrease)	(142 500 - 96 350)	46 150
		2 826 183

Solution 22.3 continued …

Alternative workings:		
Payments to suppliers for goods for resale		2 510 950
= Opening accounts payable + purchases - closing accounts payable	(142 500 + 2 464 800* - 96 350)	
opening inventory + ***purchases*** * – closing inventory = cost of sales	(131 200 + ***2 464 800*** – 146 000 = 2 450 000)	
Operating expenses paid		315 233
Operating expenses per the Statement of comprehensive income		339 950
Non-cash items:		
Depreciation	(168 000 - 120 000 + 60 000 - 0)	(108 000)
Profit on sale of land & buildings	(520 000 – 450 000) (also the transfer to NDR)	70 000
Profit on sale investments		12 450
Doubtful debts allowance	(6 133 - 5 640)	493
Increase in prepayments	(6 300 - 5 960)	340
		2 826 183

Following not required as part of answer:

Amortisation table Date	Nominal interest	Effective interest	Premium	Premium balance	PV
1/10/X5				30 000	530 000
1/10/X6	100 000	96 844	3 155	26 845	526 844
1/10/X7	100 000	96 268	3 732	23 113	523 112
1/10/X8	100 000	95 586	4 414	18 699	518 698
1/10/X9	100 000	94 779	5 221	13 478	513 478
1/10/Y0	100 000	93 825	6 175	7 303	507 303
1/10/Y1	100 000	92 697	7 303	-	500 000

Cash flow		
1/10/X5	530 000	
1/10/X6	(100 000)	
1/10/X7	(100 000)	
1/10/X8	(100 000)	
1/10/X9	(100 000)	
1/10/Y0	(100 000)	
1/10/Y1	(600 000)	(500 000) + (100 000)

Effective interest rate = 18.2725377

Solution 22.3 continued …

c)

Return on assets (ROA/ROI)

$$\frac{\text{Profit for period + interest expense (1 – tax rate)}}{\text{Average total assets}} \times 100 \quad \frac{399\,094 + (136\,268 \times .65)}{(3\,139\,900 + 3\,105\,100)/2}$$

= 15.6%

Return on equity (ROE)

$$\frac{\text{Profit for period – preference dividends}}{\text{Average ordinary shareholders equity}} \times 100 \quad \frac{399\,094 - 25\,000}{((2\,007\,549 - 272\,700) + (1\,585\,755))/2}$$

= 22.5%

The return on equity exceeds the return on investment, which indicates that the company is effectively geared. The after tax cost of debt is less than the return on investment.

Solution 22.4

MT GRACE
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 20X5

		C
Cash flows from operating activities		
Cash receipts from customers	W1	5 057 000
Cash paid to suppliers and employees	W2	(4 263 922)
Cash generated from operations		793 078
Interest paid	W3	(24 000)
Dividends paid	W4	(30 000)
Taxation paid	W5	(252 043)
Net cash inflow from operating activities		***487 035***

Workings

W1 Cash received from customers

Accounts receivable				Doubtful debts allowance			
Description	**C**	**Description**	**C**	**Description**	**C**	**Description**	**C**
Balance	720 000	Bad debts	^18 000			Balance	34 000
Sales	5 200 000	***Cash***	***5 057 000***			Bad debts	37 500
		Balance	845 000	Balance	71 500		
	5 920 000		5 920 000		71 500		71 500

^(55 500 – 37 500)

W2 Cash paid to suppliers and employees

Revenue from sales	5 200 000	
Profit before tax	680 000	
Net expenses (including COS)	(4 520 000)	Debit
Items shown separately on face of CFS		
Interest expense	25 578	
Non-cash items		
Bad debts	18 000	
Increase in doubtful debts allowance	37 500	
Depreciation	100 000	
	(4 338 922)	Debit
Accrual basis of accounting		
Increase in inventory	95 000	
Increase in accounts payable	(170 000)	
	(4 263 922)	

Solution 22.4 continued …

W3 Interest

Effective interest rate = 12.621908%

Date	Interest	Dividend	Premium	Premium balance	PV
01/07/X2					200 000
30/06/X3	25 241	24 000	1 244	1 244	201 244
30/06/X4	25 401	24 000	1 401	2 645	202 645
30/06/X5	25 578	24 000	1 578	4 223	204 223

W4 Ordinary dividend

Ordinary dividend liability

Description	C	Description	C
Bank	***30 000***	Balance	30 000
		Dividend	35 000
Balance	35 000		
	65 000		65 000

W5 Taxation

		X 0.29	
Profit before tax	680 000	197 200	
Permanent differences			
Interest on preference shares	25 578		
	705 578	204 618	Dr TE
Temporary differences	(60 000)	17 400	Cr DT
Depreciation	100 000		
Tax allowances	(160 000)		
Taxable income	645 578	187 218	Cr CTP

Taxation expense

Description	C	Description	C
Current tax payable	187 218	Retained earnings	204 618
Deferred tax	17 400		
	204 618		204 618

Current tax payable

Description	C	Description	C
Bank	***252 043***	Balance	190 000
		Tax expense (NT)	187 218
Balance	125 175		
	377 218		377 218

Deferred tax

Description	C	Description	C
		Balance	81 200
		Tax expense	17 400
Balance	98 600		
	98 600		98 600

* (35 000 + 24 000) X 0,125

Solution 22.5

SHINE LIMITED
EXTRACT FROM STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 20X4

		C
Cash in/ (out)flows from operating activities		(28 550)
Cash receipts from customers		180 500
Cash paid to suppliers and employees	(102 + 48.5)	150 500
Cash generated from operations		30 000
Taxation paid		(19 050)
Interest paid	[15.784 – (64.716 x 11.255% - 60.000 x 10%)]	(14 500)
Dividends paid		(25 000)
Cash in/ (out)flows from financing activities		(66 000)
Redemption of preference shares		(66 000)

Workings:

Figure in 000 s

Accounts receivable

Balance	20	Bad debts	1.5
Sales	*252	***Cash***	***180.5***
		Balance	90
	272		272

Inventory

Balance	131.5	Cost of sales	120
Purchases	100	Balance	111.5
	231.5		231.5

Accounts payable

Cash	***102***	Balance	10
Balance	8	Purchases	100
	110		110

Administration expenses accrued

		Balance	-
Balance	2	***Expenses***	***2***
	2		2

Preference share liability

Cash	***66***	Balance	64.716
Balance	-	Finance cost	^1.284
	66		66

Distribution expenses prepaid

Balance	2		
Cash	***1***	Balance	3
	3		3

* (120 X 210 / 100)
^ ((64 716 X 0.11255) – 6 000]

Solution 22.5 continued …

Figure in 000 s

Retained earnings			
CRRF	60	Balance	80
Dividends	***23***	Profit and loss (profit)	33.741
Balance	30.741		
	113.741		113.741

Shareholders for dividends			
		Balance	2
Cash	***25***	Dividends	23
Balance	-		
	25		25

Deferred tax asset			
Balance	20		
Tax expense	***2.5***		
		Balance	22.5
	22.5		22.5

Current tax payable			
		Balance	10
Cash	***19.050***	Tax expense	~ 21.975
Balance	12.925		
	31.975		31.975

~ (19.475 TE + 2.5DT)

Calculation of "Supplier" operating costs	
Sales (COS: 120 000 + Mark-up: 120 000 x 110%)	252 000
Cost of sales (Given)	(120 000)
Gross profit	132 000
Operating costs (balancing figure)	***(78 784)***
Profit before tax (given)	53 216
Operating costs (above)	78 784
Adjusted for non-cash items included:	
Profit on sale of plant	3 000
Bad debts	(1 500)
Depreciation	(15 000)
Adjusted for items shown separately on face of statement of cash flows	
Finance charges	(15 784)
Adjusted for related accruals and prepayments:	
Admin expenses accrued	(2 000)
Distribution expenses prepaid	1 000
Cash operating expenses relating to suppliers	48 500

Profit before tax	53 216
Less: profit on sale of plant	(3 000)
Add: bad debts	1 500
Add: depreciation	15 000
Add: finance costs	15 874
	82 500
Changes in Working Cap:	
Less increase in trade and other receivables	(71 000)
Add decrease in inventory	20 000
Increase/ (decrease) in trade/ other payables	0
Cash generated from operations	31 500

Solution 22.6

a)

MEADOWVALE MANUFACTURERS LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

		C000
Cash flows from operating activities		
Cash receipts from customers	W1	4 625
Cash paid to suppliers and employees	W2	(4 484)
Cash generated from operations		141
Investment income received	Given	18
Interest paid	Given	(92)
Taxation paid	(470 + 800 – 600)	(670)
Dividends paid	(180 + 295 – 150)	(325)
Net cash inflow from operating activities		*(928)*
Cash flows from investing activities		
Purchase of land and buildings	W3	(265)
Proceeds on sale of land and buildings	W3	140
Purchase of plant and machinery	W6: 71 + 279	(350)
Proceeds on sale of plant and machinery	W6	144
Purchase of investments	W5: 20 + 12	(32)
Net cash outflow from investing activities		***(363)***
Cash flows from financing activities		
Redemption of preference shares	100 000 x C1 x 1.04	(104)
Issue of ordinary shares	W4	125
Long-term loan raised	970 - 180	790
Net cash inflow from financing activities		***811***
Net increase in cash		(480)
Cash at beginning of period		620
Cash at end of period		**140**

NOTE TO THE STATEMENT OF CASH FLOWS

Non-cash financing and investing activities

1. Land and buildings were revalued by C20 000 during the year.

2. An amount of C100 000 was transferred during the year to the capital redemption reserve fund as a result of the redemption of preference shares.

3. A capitalisation issue to the value of C125 000 was made out of the capital redemption reserve fund.

4. The company acquired plant and machinery of C100 000 during the year, of which C29 000 was financed by the trade-in of old plant and machinery.

Solution 22.6 continued …

b)

Figure in 000 s

Reconciliation	
Profit before tax (from SOCI)	1 519
Adjusted for non-cash and non-operating items	223
Investment income (from SOCI)	(18)
Interest expense (from SOCI)	92
Depreciation – plant	90
Profit on sale of land and buildings	(50)
Profit on sale of plant and machinery	(4)
Writedown of listed investments	7
Goodwill	100
Loss on trade-in of plant and machinery	6
Operating cash flow before working capital changes	1 742
Working capital changes	(1601)
Accounts receivable	(370)
Inventory	(1 591)
Accounts payable	360
Cash generated from operations	**141**

Workings

W1. Cash receipts from customers

Opening accounts receiveable	500 000
Sales	5 000 000
Closing accounts receivable	(870 000)
Bad debts	(5 000)
	4 625 000

W2. Cash paid to suppliers and employees

Sales	5 000 000
Profit before tax	(1 519 000)
Net expenses for year	3 481 000
Elimination of items shown separately on face of Statement of cash flows	
Dividends received	18 000
Interest	(92 000)
Elimination of non-cash items	
Bad debts	(5 000)
Depreciation	(90 000)
Profit - sales of land and buildings	50 000
Profit - sale of plant and machinery	4 000
Write down of investment	(7 000)
Goodwill	(100 000)
Loss on trade - in of plant & machinery	(6 000)
Elimination of the effects of accrual accounting	3 253 000
Increase inventory	1 591 000
Increase in accounts payable	(360 000)
	4 484 000

Solution 22.6 continued …

W3

Figure in 000 s

LAND AND BUILDINGS			
Description	***C***	***Description***	***C***
Balance	2 405	Disposal	90
NDR / DT	20		
Bank	***265***	Balance	2 600
	2 690		2 690

DISPOSAL LAND AND BUILDINGS			
Description	***C***	***Description***	***C***
Land and buildings	90	***Bank***	***140***
Profit on sale of land and buildings	50		
	140		140

W4

ORDINARY SHARE CAPITAL			
Description	***C***	***Description***	***C***
		Balance	450
		CRRF (Cap issue)	125
Balance	700	***Bank (issued shares)***	***125***
	700		700

CAPITAL REDEMPTION RESERVE FUND			
Description	***C***	***Description***	***C***
Ordinary share capital (Cap issue)	***125***	Balance	50
		Retained earnings (Redemption of preference shares)	100
Balance	25		
	150		150

W5

UNLISTED INVESTMENTS			
Description	***C***	***Description***	***C***
Balance	44		
Bank	**20**		
		Balance	64
	64		64

LISTED INVESTMENTS			
Description	***C***	***Description***	***C***
Balance	84	Writedown	7
Bank	**12**		
		Balance	89
	96		96

Solution 22.6 continued …

W6

Figure in 000 s

PLANT AND MACHINERY			
Description	***C***	***Description***	***C***
Balance	426	Disposal (machine)	60
Disposal (trade in)	29	Disposal (plant) (140 + 15)	155
Bank (100 – 29)	71		
Bank (purchases)	***279***	Balance	590
	805		805

ACCUMULATED DEPRECIATION PLANT AND MACHINERY			
Description	***C***	***Description***	***C***
Disposal (machine)	25	Balance	180
Disposal (plant)	***15***	Depreciation	90
Balance	230		
	270		270

DISPOSAL: PLANT AND MACHINERY			
Description	***C***	***Description***	***C***
Plant and machinery	60	Accumulated depreciation: plant and machinery	25
		Loss on trade in	6
		Plant and machinery (trade in)	***29***
	60		60
Plant and machinery...1	***155***	Accumulated depreciation: plant and machinery	15
Profit on sale of plant and machinery	4	***Bank…2***	***144***
	159		159

W7

NON DISTRIBUTABLE RESERVE			
Description	***C***	***Description***	***C***
		Balance	120
		Retained earnings	30
Balance	164,2	***Land & buildings***	***14,2***
	164,2		164,2

Solution 22.6 continued …

Figure in 000 s

DEFERRED TAXATION			
Description	***C***	***Description***	***C***
		Balance	0
		Land & buildings	***5.8***
Balance	5,8		
	5.8		5.8

c)

The company's cash management does not appear satisfactory. Cash from operating activities was negative (an amount of C603 000 after investment income, interest and tax), yet the company still paid out dividends of C250 000 to the ordinary shareholders during the year. These dividends appear to have been financed by the long term loan raised during the year, which is not good business practice.

The company's gearing increased from 6% to 28% over the two years. Although the level is not excessive, the purpose for which the loan was used, namely to finance operations and pay dividends is concerning. Purchases of non-current assets only amounted to C331 000 after recoveries from sales, which means that C480 000 of the long term financing (borrowings plus share capital issued) financed the dividends and the shortfall from operations.

There has been a substantial increase in inventory holdings in 20X7. This increase has not been accompanied by similar increases in accounts receivable and payable, which would appear to indicate excessive inventory holdings, tying up cash resources.

The increase in accounts receivable has also been greater than the increase in accounts payable, which is further aggravating the cash outflow from operating activities. It appears from the above that the company needs to address its working capital management.

It is also interesting to note that the provisional payments made for the year (C200 000) are very low in comparison to the previous year's provision for tax (C470 000). This probably resulted in penalties being incurred, which were an unnecessary drain on resources.

Solution 22.7

SPENDEE LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 20Y0

		20Y0 C
Cash effects of operating activities		102 344
Cash receipts from customers	(30+1750-20)	1 760 000
Cash Payments to suppliers and employees	W1	(1 561 856)
Cash generated from operations	See part (b)	198 144
Interest paid		(20 000)
Tax paid	[39 800 - (DT: 45 000 – 37 000) + (Current tax payable: 19 000 – 12 000)]	(38 800)
Dividends paid	(12 000 + 30 000 – 5 000)	(37 000)
Cash effects of investing activities		(212 144)
Plant purchased for expansion	W3 or (300 000 – 75000 – 22000 + 15 000 – 400 000 – 1 644)	(183 644)
Proceeds from sale of machinery	(22 000 + 8 000)	30 000
Development costs paid	W2	(58 500)
Cash effects of financing activities		68 356
Proceeds from issue of debentures		8 356
Proceeds from issue of ordinary shares	(50 000 + 10 000)	60 000
Net cash outflow		(41 444)
Opening cash and cash equivalents		900
Closing cash and cash equivalents		(40 544)

SPENDEE LIMITED
NOTES TO THE STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 20Y0

Non cash investing and financing activities	**C**
Revaluation of land and buildings	15 000

b)

Reconciliation between cash generated from operations and profit before tax		**20Y0 C**
Profit before tax		106 000
Add finance costs		20 000
Less profit on sale of machinery		(8 000)
Add depreciation on plant		75 000
Add amortisation of development costs	70000/10*6/12	3 500
Add depreciation on equipment		1 644
		198 144
Increase in trade accounts payable		10 000
Increase in inventories		(20 000)
Decrease in accounts receivable		10 000
		198 144

Solution 22.7 continued …

Workings

W1 **Figures in 000s**

Accounts payable			
Description	***C***	***Description***	***C***
Balance	***1 402***	Balance	42
		Inventory	1 412
Balance	52		
	1 454		1 454

Inventory			
Description	***C***	***Description***	***C***
Balance	50	COS	1 392
Accounts payable	***1 412***		
		Balance	70
	1 462		1 462

Current tax payable			
Description	***C***	***Description***	***C***
Bank	***38.8***	Balance	19
		Tax expense	31.8
Balance	12		
	50.8		50.8

Deferred tax			
Description	***C***	***Description***	***C***
Balance	45	Balance	37
		Tax expense	8
	45		45

Tax expense			
Description	***C***	***Description***	***C***
Balance	0		
Deferred tax	8		
Current tax payable	***31.8***		
		Balance	39.8
	39.8		39.8

Cash paid to suppliers and employees		**C**
Cash paid to suppliers for goods for resale		*1 402 000
Cash paid for other operating expenses	(240 – 75 – 1.644 -3.5)	159 856
		1 561 856

W2 Development costs

	A	**B**	**Total**
Opening balance	***20 000***	***30 000***	50 000
Incurred during year	50 000	8 500	58 500
Total	70 000	38 500	108 500
Less amortisation /10*6/12	3 500		3 500
Closing balance	66 500	38 500	105 000

Solution 22.7 continued …

W3 Property, plant and equipment

Opening balance	300 000	given
Sale	(22 000)	given
Revaluation of land	15 000	given
Depreciation - plant	(75 000)	given
Depreciation - equip	(1 644)	given
Purchase of machinery	***183 644***	***balancing***
Closing balance	400 000	given

Solution 22.8

BIG FOOT LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 20X8

		20X8
		C
Cash effect of operating activities		(41 130)
Cash receipts from customers	45 000 + 654 000 - 110 000	589 000
Cash payments to suppliers and employees	Balancing or W2	585 130
Cash generated from operations	W1	3 870
Interest paid	9 000 + 17 000 - 4 500	(21 500)
Tax paid	[5 000 + (3 000 + 21 000 – 15 000) – 12 000]	(2 000)
Dividends paid	29 000 + 10 000 - 17 500	(21 500)
Cash effects of investing activities		(283 834)
Expansion/ purchase of land and buildings	(320 000 - 300 000)/2	(10 000)
Purchase of plant and machinery	(312 964 + 15 866 + 20 222 + 10 648 – 110 000)	(249 700)
Sale of plant and machinery	15 866+20 000	35 866
Development costs paid		(60 000)
Cash effects of financing activities		297 036
Proceeds from issue of shares	(32 000 X 1.25)	40 000
Repayments of long-term loan	given	(80 000)
Proceeds from raising of long-term loan	(527 036 – 260 000 + 80 000 – 10 000)	337 036
Net cash in/ (out) flow		(27 928)
Opening cash and cash equivalents		159 000
Closing cash and cash equivalents		131 072

Solution 22.8 continued …

Workings

W1. Cash generated by operations

			20X8 C
Profit before tax			16 000
Adjust for non-cash flow and separately disclosable items:			
Add	interest expense		17 000
Add	depreciation		20 222
Add	write-down on plant and machinery		10 648
Less	profit on sale of P&M		(20 000)
Add	amortisation of Dev Costs	(100000+20000) x 6 / 24	30 000
			73 870
Adjust for changes in working capital			
Less	increase in inventories	(-120 000 + 80 000)	(40 000)
Less	increase in debtors	(-110 000 + 45 000)	(65 000)
Add	increase in creditors	(55 000 – 20 000)	35 000
Cash generated by operations			3 870

W2 Cash payments to suppliers and employees:

Payments to suppliers of goods for resale		299 000
= Opening accounts payable + purchases - closing accounts payable	(20 000 + 334 000* - 55 000)	
*Purchases = COS + CI - OI	(294 000 + 120 000 – 80 000 = 334 000)	
Operating expenses paid		286 130
Operating expenses		347 000
Non-cash items:		
Depreciation		(20 222)
Write down on plant and machinery		(10 648)
Amortisation of development costs		(30 000)
Cash payments to suppliers and employees		585 130

Solution 22.9

a)

SAURON STEEL
EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS

	C
Taxation expense	
Normal income tax	21 000
• Current tax	6 000
o Current year	8 000
o Over-provision in prior year	(2 000)
• Deferred normal tax	15 000
Tax expense	21 000

Tax rate reconciliation

	C	%
Normal tax at applicable rate	24 000	30.0
Exempt item: Dividend income [taxed @ 10% (5 000 x 20%)]	(1 000)	(1.25)
Overprovision in prior year	(2 000)	(2.5)
Income tax expense at effective rate	22 375	26.25

Deferred tax liability

Revaluation surplus	45 000
Plant	40 500
Machinery	10 500
	96 000

Solution 22.9 continued …

b)

SAURON STEEL LIMITED
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 20X2

Profit before tax		80 000
+/- Non cash items		
Depreciation	(65 000+15 000+5 000)	85 000
		115 000
+/- Non operating items		
Dividends received		(5 000)
Interest paid	(800 000 x 15%)	120 000
		95 625
+/- Changes in working capital		
Increase in accounts receivable		(90 000)
Decrease in inventories	(300 000 - 55 000 - 100 000)	145 000
Decrease in accounts payable		(150 625)
Cash generated from operations		184 375
Dividends received		5 000
Interest paid		(120 000)
Normal tax paid	(7 000 – 2 000 + 8 000)	(13 000)
Dividends paid		(20 000)
Cash generated from operating activities		36 375
Cash flows from investing activities		
Purchase of land and buildings		(50 000)
Purchase of investments in listed companies		(60 000)
Purchase of Machinery		(20 000)
Cash flows from financing activities		
Issue of ordinary shares at a premium	(110 000 – 5 000)	105 000
Movements in cash and cash equivalents for the year		11 375
Balance in cash and cash equivalents at the beginning of the year		55 000
Balance in cash and cash equivalents at the end of the year		66 375

Solution 22.9 continued . . .

Workings

Depreciation and deferred tax

Plant

		CA	TB	TD	DT
01/01/X0	Cost	600 000	600 000		
01/01/X0 – 31/12/X1	Depreciation / W&T	(100 000)	(200 000)		
31/12/X1	Balance	500 000	400 000	100 000	30 000Cr
01/01/X2	Revaluation	150 000	-	150 000	45 000Cr
31/12/X2	Depreciation / W&T	(65 000)	(100 000)	35 000	10 500Cr
		585 000	300 000	285 000	85 500Cr
Depreciation / W&T		**65 000**	**100 000**		

Machinery

		CA	TB	TD	DT
01/01/X0	Cost	120 000	120 000		
	Depreciation/ W&T	(20 000)	(40 000)		
31/12/X1	Balance	100 000	80 000	20 000	6 000Cr
30/06/X2	Acquisition	120 000	120 000		
31/12/X2	Depreciation/ W&T (10 000 + 5 000) (20 000 + 10 000)	15 000	30 000	15 000	4 500Cr
		205 000	170 000	35 000	10 500Cr
Depreciation / W&T		**15 000**	**30 000**		

Furniture

Depreciation W&T	**5 000**	**5 000**
Total depreciation / W&T	**85 000**	**135 000**

Deferred tax

Opening balance	36 000
Revaluation	45 000
Taxable TD on plant	10 500
Taxable TD on machinery	4 500
	96 000

Solution 22.9 continued …

Prior year tax	
Amount assessed	60 000
Amount provided	62 000
Over provision	2 000
Amount assessed	60 000
Amount paid	55 000
Amount owing to taxation authorities	5 000

Tax calculation 20X2		**X 0.30**	
Profit before tax	80 000	24 000	
Dividends received	(5 000)		
	75 000	22 500	Dr TE
Temporary differences	(50 000)	(15 000)	Cr DT
+ depreciation	85 000		
- wear and tear	(135 000)		
Taxable profit	25 000	7 500	Cr CTP
Dividends (taxed @ 10%)	5 000	500	
		8 000	

c)

Interest cover

Interest cover measures the amount of times the profit exceeds the interest payment, and this provides information to lenders of money regarding the company's ability to repay interest from profits. The interest-cover of Sauron Steel Limited is calculated as follows:

Interest cover = (80 000 + 120 000) / 120 000 = 1.67

This is a relatively healthy interest cover as the company does generate enough profits to cover its interest payments.